

VERMEER NEWSLETTER

July 2020



THOUGHTS ON 2020

The Twilight Zone



By Simon King
Chief Investment Officer

T +44 (0)20 7123 5204

E simon.king@vermeerllp.com

- Markets continue to dislocate from economies
- Fiscal stimulus moves to second stage
- Huge bifurcation in stock performance
- Change produces opportunities

We have generally tried to avoid commenting on every twist and turn in the current crisis, choosing instead to set out our thoughts of the longer-term implications of the present malaise. Although it is only a month since our most recent missive, we thought it appropriate to reiterate our current thoughts and views as we move into the second half of an already remarkable year. Although it may not feel like it, not much has changed with the level of economic uncertainty, lack of medical progress and the dislocation of the performance of many asset markets from economic reality all continuing. Many people are in a state of suspended reality as they navigate a Twilight Zone period when they know things are going to be different and difficult but are not prepared to visualise what the future really looks like or what it may cost.

From a global fiscal and monetary policy perspective it has been interesting to view how we have now moved on to a second phase in many countries. Most central banks have broadly continued with a “whatever it takes” strategy with the US Federal Reserve in particular snuffing out any pockets of market weakness with a seeming unending supply of liquidity. The main issue with this is that markets now assume there are no assets the Fed will not buy, which leads to irrational buying i.e. it creates a moral hazard. Governments, however, have started to turn to more targeted measures as the sheer cost and reduced marginal impact of the initial blunt instrument blockbusters they put into place at the outset of the crisis have made them impossible to repeat. Although the cost of these programmes is less, they are still huge numbers in absolute terms.

The US remains hamstrung by its failure to get control of the Covid-19 virus. We outlined our fears on this at the start of the crisis and unfortunately the frustrating scenario of major parts of the global economy bottoming out, the spread of Coronavirus, and looking to mount a sharp economic recovery will be severely hampered by the world’s largest economy being restricted at a social level. It is not clear how the situation will be impacted by the forthcoming Presidential election but the prospect of the current incumbent being further destabilised is not an attractive one.

In the UK we saw the latest manifestation of a more targeted approach with the Chancellor delivering his Summer Statement. Like most of the current Government’s policy announcements in 2020 it initially looked sensible but then did not hold up well to public scrutiny. It appears to us that the Chancellor has broadly the right ideas but has no confidence in the Government’s ability to deliver and administer them. As such there is a tendency to avoid measures which are very targeted even though they are the most appropriate ones. The back to work bonus for firms taking back furloughed workers was a good example with a good idea not being thought through and the incentive simply being too small.

As we have previously commented we are amazed at the bifurcation in the performance within different asset classes, particularly the equity markets. Many share prices do reflect the scale of uncertainty and financial damage that Covid-19 has inflicted on their prospects, but a large number simply assume everything will return to normal in a very short period. The market is likely to be severely tested as we move through the earnings reporting season which is just starting. The numbers being reported will not be that relevant. What will be important is what happens to forecasts for 2021 earnings where we believe analysts are generally being hopelessly over optimistic and that there will be substantial negative earnings revisions.

We are generally great supporters of the large US technology companies, but we are concerned about the proportion of the overall stock market they now represent and the extent to which they drive market performance. There are numerous theories as to why this is happening ranging from a new technology paradigm to excess liquidity having nowhere to go except into the very largest stocks. At Vermeer we focus on the individual companies and their valuations and try not to jump on bandwagons to justify our positions.

In summary, we believe that investors will be travelling through the Twilight Zone for the rest of 2020. If the US manages to regain medical control then things may become clearer a little sooner but until there is more clarity, we believe there will simply be a lack of decision making by governments, companies

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and crucially consumers that will stymie any meaningful recovery. We continue to believe that despite all the financial uncertainty and financial turmoil that there will be huge opportunities for companies that quickly adapt to however the world looks after Covid-19 and that we must redouble our efforts to find them.

Simon King
Chief Investment Officer

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